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NSC FOR JSHRIER
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E.O. 12958: DECL: 05/09/2018
TAGS: ECON EFIN PGOV VE
SUBJECT: CADIVI AT FIVE YEARS: GETTING WORSE

REF: A. 2007 CARACAS 2330
¶B. CARACAS 535
¶C. CARACAS 473
¶D. CARACAS 587
¶E. CARACAS 190
¶F. CARACAS 376
¶G. CARACAS 494
¶H. CARACAS 532
¶I. CARACAS 597

Classified By: Acting Economic Counselor Shawn E. Flatt for reasons 1.4 (b) and (d).

¶1. (C) Summary: Complaints about delays and corruption in CADIVI, the BRV's Commission for Administering Foreign Exchange, are increasing among private sector contacts. Although it has authorized more foreign currency liquidation on a daily basis thus far in 2008 than it did in on average 2007, CADIVI cannot keep up with the demand. It has increasingly begun to channel authorizations to priority economic sectors such as food and medicine, creating new distortions in the economy. The BRV has experimented with alternatives to CADIVI but seems unlikely to dismantle foreign exchange controls. End summary.

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Exchange Controls plus Overvalued Currency = Rationing
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¶2. (C) The basic structural problem faced by CADIVI remains unchanged since our last message (ref A). The Central Bank (BCV), per our understanding and according to a mid-level CADIVI contact, determines how much foreign exchange can be sold at the official rate (2.15 bolivars (Bs) per USD) during a given time period. At this price, the bolivar is overvalued: neither rising oil prices nor a weaker dollar (both of which would tend to make the bolivar appreciate against the dollar) can compensate for the effect of accumulated inflation of over 65 percent since March 2005, when the current official rate was set. Another indication that the official rate is overvalued is the parallel foreign exchange rate, which began to diverge significantly from the official rate in the fall of 2006.

¶3. (U) Because dollars are cheap at the official rate, demand for dollars far exceeds what the Central Bank is willing to sell. (Note: CADIVI does not publish statistics on the amount requested, but every indication is that the

amount has grown astronomically in the past year-plus. End note.) It is CADIVI's job to determine which requests are fulfilled, i.e. to ration the sale of foreign currency at the official rate. In 2007, CADIVI approved liquidation of USD 43 billion, equivalent to an average of USD 172 million per working day. To date in 2008, CADIVI has approved liquidation of an average of USD 182 million per day, six percent more than the 2007 average but 11 percent less than the average for the fourth quarter of 2007.

Rationing 101: Changing the Ratios

¶4. (SBU) CADIVI has announced several significant changes to its approach to rationing in 2008. Most importantly, CADIVI has purposefully directed a greater percentage of its approvals to importers of food, medicines, and capital goods, determined by the BRV to be "priority sectors." This re-direction has accelerated since President Chavez questioned CADIVI's 2007 allocations in a January "Alo Presidente" broadcast: "How can it be that we gave more dollars for vehicle imports than for food imports in 2007? That's a horrible thing." Indeed, the food sector's relative share of CADIVI dollars for imports has risen in 2008 (from 11 to 14 percent) and the automobile sector's has fallen slightly (from 19 percent to 18 percent). (Comment: Surprisingly, the automotive sector is still getting more "CADIVI dollars" than the food sector. End comment.) CADIVI has also restricted the opportunities individual Venezuelans have for accessing CADIVI dollars by reducing the maximum annual reimbursement for credit card purchases from 3,000 to 400 USD and by eliminating, in conjunction with the BRV's banking regulator, the use of pre-paid credit cards for purchases or currency withdrawals abroad.

Rationing 102: Enter the Bureaucracy

¶5. (C) Dealing with CADIVI is a bureaucratic nightmare, and CADIVI has used bureaucracy to reinforce its new priorities. For certain priority products, CADIVI has authorized pre-liquidation of currency (so the BCV can surrender dollars before the goods have arrived in country) and has developed a "one-stop shopping" system for getting the required permits. (Note: Before requesting currency for a specific transaction, companies must ensure that they have on file with CADIVI at least 8 valid certificates. These certificates, which last between one month and one year, must be obtained from a variety of ministries and government entities, including the Social Security Administration, the Ministry of Labor, and the Ministry of Light Industry and Commerce. End note.) At the same time, CADIVI is increasing the bureaucratic requirements for certain non-priority currency requests. For example, CADIVI is now requiring a new form for imports coming through the Latin American Association for Integration (ALADI) convention.

¶6. (C) For non-priority sector companies that have dotted their i's and crossed their t's, it becomes a waiting game. Some companies complain that their waits are getting longer, up to six months between when they make a request to acquire dollars and when CADIVI authorizes the BCV to liquidate the currency. Other companies report that authorizations are unpredictable, and still others report that they are not having significant problems with CADIVI. Corruption clearly plays a role: our contacts report that the going rate for getting fast-track authorization is 0.6 Bs per dollar.

Different Year, Different Distortions

¶7. (C) The changes to CADIVI's ratios and bureaucratic processes are creating a new set of distortions in Venezuela's economy. By prioritizing food imports, CADIVI is undermining President Chavez' goal of increasing agricultural

production in Venezuela. Furthermore, several VenAmCham members are predicting a "perfect storm" of problems leading to severe near-term shortages. While this prediction may be overblown, it is clear that CADIVI's changes are hurting several sectors that are key to the supply chain, including packaging and transport. One packaging company said that its parent company in the U.S. had halted raw material shipments until the Venezuelan franchise's CADIVI backlog was cleared. Auto sales are falling thanks largely to an explicit BRV policy to reduce imports (ref B), and local auto assemblers and auto parts dealers are suffering as well.

¶8. (C) The longer CADIVI endures, the more entrenched other long-standing distortions are becoming. Small businesses, which lack the administrative capacity or economies of scale to allow them to manage the CADIVI process, are particularly hurt. The spouse of one of our contacts, who runs a small business, has been waiting 18 months to get CADIVI approval for royalty payments. Exporters are also suffering. To add insult to injury, exporters have to get CADIVI approval before exporting, as well as being required to exchange their foreign currency earnings for bolivars at the official rate. Finally, as the currency exchange regime becomes more unpredictable, businesses of all types are trying to increase their inventories. Many VenAmCham members report they have had to increase working capital up to seven times in recent years, largely as a result of CADIVI's unpredictability.

New Alternatives to CADIVI?

¶9. (SBU) Given its increasing year-on-year authorizations, CADIVI, which turned five years old this spring, appears to be an institution with staying power. Nonetheless, there are alternatives. A number of BRV agencies do not go through CADIVI to import. A significant recent addition to this list is PDVAL (ref C), a food production and distribution company that uses the procurement arm of PDVSA, the state oil company and PDVAL's owner, to import. According to one supplier to a dairy products company recently acquired by the state, suppliers to the BRV's growing network of food companies may soon be authorized to import through PDVSA's procurement arm as well.

¶10. (SBU) For the private sector, the parallel foreign exchange market and BRV sales of bonds and structured notes offer alternative, but more expensive, ways to get dollars for imports (refs D and E). BRV intervention and other factors have brought the parallel rate down to 3.3 Bs/USD from a high of 6.8 Bs/USD in November 2007 (ref F), making parallel market imports more feasible from a cost perspective. Companies' approaches to using the parallel market vary widely. One wine importer, unable to get the same flow of currency through ALADI to import Chilean wines, is obtaining some dollars through the parallel market and raising prices accordingly. Some companies have interpreted the law against illegal currency exchange operations as saying parallel market transactions above USD 10,000 are illegal. Other companies, including a number of large multinationals, are reluctant to use the parallel market at all, largely for legal, accounting, and tax reasons.

Comment

¶11. (C) Foreign exchange controls are a logical tool for the BRV given President Chavez' penchant for control and the country's dependence on imports and exports. Chavez seems unlikely to give up this tool. In an April 2008 "Alo Presidente" broadcast, he promised to make the exchange controls more "flexible" but vowed not to give them up. As CADIVI passes its fifth anniversary and the bolivar becomes more overvalued at the official rate, CADIVI's record is predictable: growing delays, growing corruption, and growing distortions. The BRV has begun to experiment with alternatives to CADIVI, such as PDVAL and the recent bond issuance. While these alternatives may make the exchange

control regime more "flexible," they cannot escape the fundamental problems of any such regime. Of course, with the price of Venezuelan oil up almost 50 percent compared to last year, the BRV can afford a significant amount of inefficiency and corruption.

¶12. (C) The specific changes the BRV has made to the exchange control regime in the past five months, as with other recent economic moves such as the nationalizations of SIDOR and the cement companies (refs G and H), are clearly designed to appeal to Chavez' constituency in advance of state and local elections scheduled for late 2008. Chavez understands that food shortages contributed to the defeat of his proposed changes to the constitution in December 2007. His determination to deal with this problem is apparent in remarks he made in an April "Alo Presidente" broadcast shortly after President Bush mentioned food shortages in public remarks: "If the enemy (i.e., the U.S.) doesn't want us to have milk, well we'll bathe ourselves in milk; and if he doesn't want there to be bread, we'll inundate Venezuela with bread so that they (the enemy) never again dare to mess with the people's food." The BRV has succeeded in reducing the shortages, at least in the short run, by redirecting CADIVI dollars to food imports and by directing additional resources through PDVAL, in addition to other measures (ref I). Of course, the price tag is a stiff one. End comment.
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